

**DEPARTMENT OF STATE REVENUE**  
**LETTER OF FINDINGS NUMBER 98-0002**  
**ST**  
**Sales And Use Tax**  
**For Tax Periods: 1994 Through 1996**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning specific issues.

**ISSUES**

**1. Sales and Use Tax-Manufacturing Exemption**

**Authority:** IC 6-2.5-3-2 (a); IC 6-2.5-3-2 (b); Indianapolis Fruit Co. v. Department of State Revenue, No. 49T10-9702-SC-00129, Indiana Tax Court (February 25, 1998; Indiana Department of Revenue v. RCA Corporation, (1974) 160 Ind. App. 55. 310 N.E.2d 96.

Taxpayer protests the assessment of use tax on many items which Taxpayer contends qualify for the manufacturing exemption.

**2. Sales and Use Tax-Agricultural Exemption**

**Authority:** IC 6-2.5-5-2; IC 6-2.5-5-1; Indiana Department of Revenue v. American Dairy of Evansville, Ind., 338 N.E. 2d 698 (Ind. App. 1975).

Taxpayer protests the assessment of use tax on many items that Taxpayer contends qualify for the agricultural exemptions.

**3. Sales and Use Tax Administration-Negligence Penalty**

**Authority:** IC 6-8.1-10-2

Taxpayer protests the imposition of the negligence penalty.

## **STATEMENT OF FACTS**

Taxpayer is a meat packer. Taxpayer purchases live animals and processes them into finished goods or items requiring further processing by the purchaser. After an audit, additional sales/use taxes were assessed for the tax periods 1994-1996. Taxpayer timely protested the assessment. More facts will be provided as necessary.

### **Sales and Use Tax – Manufacturing Exemptions**

#### **DISCUSSION**

Pursuant to IC 6-2.5-3-2(a), Indiana imposes an excise tax on tangible personal property stored, used, or consumed in Indiana. A number of exemptions are available from use tax, including those collectively referred to as the manufacturing exemptions and the agricultural exemptions. All exemptions must be strictly construed against the party claiming the exemption. Gross Income Tax Division v. National Bank and Trust Co., (1948) 226 Ind. 298, 79 N.E. 2d 651.

Taxpayer's first point of protest concerns the assessment of additional use tax on purchases used in the livestock unloading and holding area. Taxpayer alleges that the purchases used in the livestock unloading and holding area qualify for the exemption of "manufacturing machinery, tools and equipment which is to be directly used by the purchaser in the direct production, manufacture, fabrication . . . of tangible personal property." IC 6-2.5-5-3 In this area, livestock waits for stunning. Taxpayer alleges it processes the hogs in this area in a way which would entitle it to the manufacturing exemption. Taxpayer presented a study titled Improving Pork Quality by Reducing the Incidence of Pale, Soft, and Exudative Pork from the 1996 Research Investment Report of M.F. Miller and C.B. Ramsey, Animal Science and Food Technology Department, Texas Tech University, Lubbock, Texas. This study supports Taxpayer's contention that stress reduction and increase of pH levels significantly improves the firmness, cooked yield, sliceability, soluble protein and values of pork products. This study indicates that allowing hogs to rest and calm down for two to three hours prior to stunning and slaughter actually changes the pH level which substantially improves the quality of the final product. This is analogous to the ripening of tomatoes. In the case Indianapolis Fruit Co. v. Department of State Revenue, No. 49T10-9702-SC-00129, Indiana Tax Court (February 25, 1998), the Indiana Tax Court denied the manufacturing exemption on the equipment holding tomatoes during ripening saying, "It is indisputable that, like the bananas, the tomatoes have undergone a substantial physical and chemical change while ripening. Although this transformation undoubtedly made the tomatoes far more marketable, the transformation was not triggered by Indianapolis Fruit. Instead, it passively awaited the ripening of the tomatoes. The ripening was not actively induced by Indianapolis Fruit and was merely incidental to the proper storage of the

tomatoes.” In Taxpayer’s situation, it allows the physical and chemical change in pH level to occur. The change makes the product more marketable, but that does not in and of itself qualify the holding pens for the manufacturing exemption. This point of protest is denied.

Taxpayer’s second point of protest concerns the assessment of use tax on a box conveyer. Taxpayer contends that this item qualifies for exemption because it is directly used in the direct production process and is required for creation of the marketable product. This equipment transports flat pieces of cardboard that are folded and glued into boxes to become the packaging for Taxpayer’s product. This process takes place separately from, and prior to the production of Taxpayer’s products. The box conveyer does not directly affect the production of meat products. Because it is not used in the production process of Taxpayer’s product, this equipment does not qualify for the directly used in direct production exemption. This point of protest is denied.

Taxpayer’s third point of protest concerns replacement computer chips (slugs) in the gambrels. These gambrels transport the meat carcasses during the production process and were purchased exempt as directly used in direct production. The original computer chips (slugs) were purchased exempt as part of the exempt equipment. The function of these chips is to be read by a computer to record various pieces of data for use in production reports, inventory reports and other documents. The data recorded by these chips and stored for reading by a computer do not have the requisite immediate link to be considered directly used in direct production and qualify for the exemption. They do not directly affect or change the product being produced. Rather these chips operate to help Taxpayer with record keeping, projections and other processes which are necessary to run a business but do not qualify for the manufacturing exemption. This point of Taxpayer’s protest is denied.

Taxpayer’s next point of protest concerns the assessment of use tax on an exhaust system and fans. The exhaust system is in the area where torches are used to glaze hams. The blowers are on the roof and pull air out of the building to help de-fog the air. Taxpayer contends that since a cool environment is necessary, these items have an immediate link with production and qualify for the equipment exemption. The Department assessed tax pursuant to 45 IAC 2.2-5-8(j). That regulation specifically states that ventilation and cooling equipment is subject to use tax. Indiana Department of State Revenue v. RCA Corporation, (1974) 160 Ind. App. 55, 310 N.E. 2d 96 deals with this issue. In that case, RCA argued that the air conditioning system was exempt because it was directly used in the direct production of the television tubes. The exhaust system and fans in Taxpayer’s case are analogous to the cooling system that the Court determined was taxable in the RCA case. Both systems are needed for production. The Court clearly stated, however, that that was not the test to determine if the system was qualified for exemption. To qualify for exemption, the air system

must have a direct effect on the production of the tangible personal property. Neither RCA nor Taxpayer's situations meet this requirement to qualify for exemption. Therefore, Taxpayer's protest to this assessment is denied.

### **FINDING**

Taxpayer's protests are denied.

### **Sales and Use Tax – Agricultural Exemptions**

### **DISCUSSION**

Taxpayer's first point of protest based on the agricultural exemptions concerns the assessment of tax on labels and the Accusort System that produces the labels. Taxpayer qualifies for the agricultural exemptions because it falls within the statutorily defined class of "other persons occupationally engaged in the business of producing food and commodities for human . . . consumption." IC 6-2.5-5-1. Taxpayer relies on Indiana Department of Revenue v. American Dairy of Evansville, Ind., 338 N.E.2d 698) Ind. App. 1975). Taxpayer alleges that this case states that products used in the production process to conform to governmental requirements qualify for the agricultural exemption. This case, however, held that certain fungicides and antibacterial agents were exempt because they were specifically listed in the agricultural exemption. It did not hold that the items were exempt because the USDA or any other government regulatory agency required them. The fact that the USDA requires the labels is not a reason to exempt from sales/use tax liability either the labels or the equipment producing the labels. Taxpayer alternatively contends that the Accusort System qualifies for exemption because it is directly used in the direct production of food products. IC 6-2.5-5-2. This agricultural exemption is interpreted in a manner analogous to the directly used in direct production manufacturing exemption. The system prints labels that are attached to the boxes that enclose the product. The labels are attached after the products are already boxed and strapped. This is clearly after the end of the production process, so the labels and system producing the labels do not qualify for the directly used in direct production test. Taxpayer's finally argues that the Accusort System qualifies for exemption as testing equipment pursuant to 45 IAC 2.2-5-8(l). Although the system does weigh the meat products, the predominant reason for the weighing is to prepare the proper label. This point of Taxpayer's protest is denied.

Taxpayer also protests the assessment of use tax on certain soaps, insecticides, chemicals, cleaners and odor controls. Taxpayer contends that these soaps, cleaners, insecticides and chemicals qualify for exemption because they are special anti-bacterial products used by the employees to avoid contamination of the food product. Taxpayer contends that the odor controls qualify for exemption

because they are required by the Indiana Department of Environmental Regulations to ensure clean air in the plant. Pursuant to the American Dairy, supra. IC 6-2-1-39(b)(1) specifically exempts insecticides and fungicides from the imposition of the use tax. Since these items clearly are to retard growth of harmful bacteria and preserve the safety of the food being produced, the court in American Dairy, supra. extended the exemption to antibacterial cleaning supplies which also retard the growth of harmful bacteria and preserve the safety of food under production. Therefore, Taxpayer's protest to the assessment of use tax on anti-bacterial soaps and cleaners is sustained. The odor controls are not specifically listed and are more like the general cleaner which the Court found taxable in American Dairy, supra. Taxpayer's protest to the assessment of use tax on the odor controls is denied.

### **FINDING**

Taxpayer's protest is denied in part and sustained in part.

### **Sales and Use Tax Administration-Penalty**

### **DISCUSSION**

Taxpayer's final point of protest concerns the imposition of the negligence penalty that was imposed pursuant to IC. 6-8.1-10-2 (a) which states as follows:

If a person fails to . . . pay the full amount of tax shown on his return on or before the due date for the return or payment, incurs, upon examination by the department, a deficiency which is due to negligence,. . . the person is subject to a penalty.

Taxpayer in this situation negligently failed to pay the proper amount of taxes due and owing to the Indiana. Therefore, the penalty properly applies.

### **FINDING**

Taxpayer's protest to the imposition of the negligence penalty is denied.